WARRINGTON
ASSET MANAGEMENT

May 2021 Market Commentary

As the S&P 500 Index ("S&P") has continued to trek higher over these past few months, it has seemingly stalled out near its all-time highs. In what we view to be a classic overbought condition, the imbalance can be relieved in a few different ways, one of which is an extended period of sideways trading. This began at the end of April, with the S&P churning in place for most of the second half of the month, and continuing into May until many of the richly-valued tech stocks sold off in a matter of days. Many point to liquidations in the ARK Innovation ETF as the cause of this cascade in addition to the growing concerns over inflation, which led the Nasdaq to drop almost 7% in eight trading days. The growing influence of speculative stocks and cryptocurrencies ("cryptos") has created a situation where selloffs in these areas can occur rapidly and have repercussions in the broader markets. The S&P ended the month with a slight gain of about 0.7%.

The Strategic program took advantage of the intramonth selloff to capture gains on multiple positions by using ratio put spreads. In a relatively low volatility market that had recently displayed smaller oscillations, our analysis began pointing to the potential for much larger moves ahead. To capitalize on this situation, we opted to use a combination of smaller, close to the money spreads, coupled with larger out of the money spreads, in the same expiration, to provide for profit opportunities in a variety of market environments. The employment of this approach led to a net gain in May of +0.55%.

The Tactical program was also able to profit from the issues caused by the decline in speculative stocks, resulting in a net gain of +0.48%. Hedging costs were minimal as we spread our put option exposure across multiple expirations and kept our positions short-term. This allowed time decay to outweigh the rise in volatility, as the CBOE Market Volatility Index rose to near 30 mid-month, the highest level since early March, before returning to within a fraction of where it began.

As we have seen so many times in history, when too few stocks begin to lead the market in one direction, the conviction in that move tends to be weak. Also, once a sideshow to the stock market, the increasing adoption of cryptos as corporate balance sheet investments, coupled with their growing use as an "asset class", has led to their increased impact on the overall equity markets. The wild volatility in a number of these cryptos bled into equity markets in May and may serve as harbinger of their influence on future market oscillations. As we discussed last month, inflation has arrived and is showing broadly in consumer products, increasing investor concern about the hidden "middle class tax increase". We will continue to seek profitable trades while we monitor these ancillary markets because as history has repeatedly shown, perturbations in seemingly unconnected areas can have outsized influence on the pricing and volatility in our domestic equity markets.

As always, we appreciate your continued support of Warrington Asset Management.